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OCA 88-1392

Sen Bradley

28 April 1988

MEMORANDUM FOR THE RECORD

SUBJECT: SOVA Briefing of Senator Bradley on Soviet Economic Issues
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1. On 28 April 1988, Doug MacEachin, [redacted] briefed Senator Bradley on Soviet economic policy and related issues at 1400 in Room SH219. John Depres, Bob Morgan, Gina Genton, Jeanne McNaughton, Chris Struab, Gary Sojka of the SSCI Staff and Gina Depres of Senator Bradley's staff and [redacted] of OCA were present. [redacted]

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2. Mr. MacEachin briefed from the attached talking points (Attachment I). He also provided Senator Bradley with the attached document (Attachment II). [redacted]

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3. In answer to Senator Bradley's basic economic question about Soviet economic prospects, Mr. MacEachin said, weather, transportation problems as usual plus Gorbachev's reforms have had an initial negative effect especially on quality control. One fundamental problem is that they tried to get investment and modernization without backing down on high growth targets. The Soviets are at an economic crossroads. They can't continue investment and consumer production without going to an external source. If the system is to change between now and the end of the century they will have to go much further. During this period our influence is marginal. We will be considered only in terms of whether we threaten or not. We can't influence actions because they have not settled on their own course yet. [redacted]

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Senate Division
Office of Congressional Affairs

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ATTACHMENT: [redacted]

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SSCI Briefing

Controversy Over Soviet Economic Growth

Want to discuss briefly the controversy about Soviet GNP that has been reported in the newspapers recently, notably in three columns by William Safire.

Perhaps should start by explaining that some Western students of the Soviet Union have believed for some time that CIA has been overstating Soviet economic growth.

- o For example, Henry Rowen--now at Stanford, but formerly head of the National Intelligence Council--has thought so since the early 1980s. Charles Wolfe of RAND and Richard Ericson of Columbia share this view.
- o But should also note that other observers--e.g., Michael Boretsky, recently retired from the Department of Commerce and others in the academic world--believe that we are understating the growth of Soviet GNP.
- o There is still another group of experts who, on balance, think we have it about right. In this connection could cite Abram Bergson of Harvard and Abraham Becker of RAND, both of whom were pioneers in developing Western estimates of Soviet GNP in current and constant prices.

During the past year, those who believe that we have overstated Soviet economic growth have found reinforcement in the glasnost-inspired accumulation of Soviet criticism of their own economic statistics.

- o For the most part, the Soviet press and journal articles are amplifying and expanding on criticisms offered by individual Soviet

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scholars since at least the early 1960s, that is, that Soviet measures of the value of output in certain sectors--particularly machine building and chemicals--embody a substantial amount of hidden inflation.

- o But in the past few years those who think our estimates of Soviet economic growth are too high have found particular support in the attention given in Soviet periodicals to the calculations of a maverick Soviet economist--Gregory Khanin.

- He has attempted estimate the growth of Soviet national income and industrial production by a variety of surrogate measures.
- Khanin concludes that Soviet economic growth is far less than official Soviet measures indicate and appreciably less than our measures shown.

Let me say that we certainly share the incredulity with which these critics approach Soviet official data--particularly value data--that is, output expressed in value terms, and most particularly aggregate value measures such as national income and the gross value of output of industry, and major industrial branches.

- o Indeed, our conviction that Soviet value statistics reflect a considerable degree of hidden inflation explains why we have dedicated a great deal of research and analysis to the development of alternative measures of Soviet economic growth.
- In fact, we have been constructing these alternative measures for about 30 years.
- Our procedures have been detailed in unclassified publications and repeatedly exposed to outside expert review.
- And, over the years, we have adjusted our procedures to take into

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account the criticisms of knowledgeable people in the academic world.

And to some extent, some of the alternative approaches we employ are in the spirit of Khanin's approach in that we employ insofar as possible various physical measures--quantities of output.

- o Our independent estimates use mostly disaggregated data published by Moscow--on quantities of output. These statistics are then multiplied by prices to obtain its value of output in constant prices in various economic sectors.

On the table shown--our estimates like Khanin's--are well below the official Soviet figures--not as much as Khanin's, but we are really closer to Khanin than we are to the official Soviet figures. We believe, however, that Khanin's measures understate estimates of economic growth because they rely entirely on gross physical indicators and implicitly assume that there has been little or no improvement in the technological level of Soviet output.

(How do we deal with this)?

From the description of our approach, it is clear that the principal potential sources of significant upward bias are, first, exaggerated Soviet data on physical output, and secondly, for that portion where we are forced to incorporate Soviet value data--the inclusion in those data of disguised inflation.

These differences in estimates of past Soviet economic growth are important primarily because of what they imply for the USSR's position today.

- o We, for example, judge that Soviet GNP is about 55% as much as US GNP and that Soviet defense outlays defined as US defense outlays are defined represent about 16% of Soviet GNP.
- o Taking the Rowen-Wolfe position of the past few weeks, Soviet GNP is only about 1/3 of US GNP and Soviet defense outlays take more than 30% of GNP.

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Evolution in Gorbachev's Views on the Economy

When Gorbachev became General Secretary he believed that the Soviet economy could be invigorated in the near term.

- o He repeatedly rejected the draft 1986-90 plan because he thought its targets were not strenuous enough.
- o He is now more defensive about what is possible and is trying to downgrade what was accomplished in the later Brezhnev era.
- o Gorbachev is reacting to the experience of 1985-87--the difficulties encountered by perestroika and the failure of economic performance to meet plans.
- o In sum, the leadership has changed its tune: they no longer believe an economic turnaround can be accomplished in the 1980s; they now imply that the effects of perestroika will not be felt in the economy until the mid-1990s or later.

Meanwhile, Gorbachev has concluded that another part of his strategy won't fly.

- o Originally, the plan was to focus on investment during 1986-90 and downplay the consumer sector.
- o Very soon into the 1986-90 plan, however, the leadership concluded that workers would not support Gorbachev's program without material improvements in their living standards.
- o So we have seen a marked increase in the goals in housing construction and new programs for health, education, and consumer services.

Gorbachev now faces other decisions.

- o His modernization program is behind schedule because of the failure of the machine building sector to produce the necessary machinery and equipment.

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- His options include holding down or reducing production of military hardware and increasing purchases of machinery from Eastern Europe and the West.
- o He could help the implementation of economic reforms by scaling back existing targets for economic growth.
- Gorbachev has talked generally about the overriding importance of qualitative as opposed to quantitative growth.
- But the 1988 economic plan shows no retreat from the goals announced in the original 1986-90 Plan.
- We suspect that Gorbachev knows that the 1986-90 economic targets are out of reach but for political reasons can't reject them.

At the same time, the leadership in the next year or so has to decide the outlines of Soviet economic policy in the 1990s.

A debate is currently in progress that pits those who would move more radically and more quickly to restrict bureaucratic interference with the economy and increase the use of market mechanisms against those who want a conservative slow moving reform effort. The results of this debate should be manifest in some or all of the following:

- o At the party conference in June the status of perestroika is to be reviewed and--presumably--new directions will be recommended.
- o This year the guidelines for the 1991-95 Plan should be formulated.
- o The basic outline for the new 15-year plan (1990-2005) are also supposed to be determined this year.
- o For us, the key question is how Gorbachev and the Soviet leadership will adjust to (a) the difficulties that perestroika has encountered thus far, and (b) the implications of these plans for Soviet military programs in the 1990s and beyond.

Ideological Constraints to Economic Reform

The pace and scope of economic reform are constrained not only by the opposition of state and party bureaucracies--who fear the loss of power and perks--but by ideological precepts that are a legacy of both Stalinism and Leninism. In many cases, these precepts represent a conscious decision by the regime to choose an egalitarian society over economic efficiency. Soviet workers and consumers have acquiesced in this decision, preferring stability and security over competition with their peers that would bring greater economic differentiation. A part of this "social contract" also appears to be a ceding by the Soviet populace to the regime of the right to participate in major decisions about strategy and policy that affect their lives as voters possess in a Western democracy.

The recognition by Gorbachev that greater economic efficiency is required for the USSR to maintain its military position vis-a-vis the US, to close the technology gap with the West, and to preserve its image as a role model for developing countries has resulted in an economic strategy that is therefore in direct conflict with Moscow's ideological heritage. Practically every element of the economic reform exposes this conflict.

Reform and Purpose

Ideological Conflict

Self-financing - To make enterprises more financially independent; ideally, they should be able to cover current and capital costs and social expenditures out of profits.

If carried to its logical conclusion, inefficient enterprises will be allowed to go out of business. This creates new uncertainties for the worker--who faces unemployment and possibly the need for retraining--and for the manager, a member of the nomenklatura, who has typically spent his entire career at the same plant.

- * Few enterprises have been allowed to go under, and in fact ministries and the State Bank have been providing financial relief to allow enterprises to meet their payrolls. This substantially undermines the discipline of self-financing.

Wage reform - To tie wages closer to individual production results and the collective effort of the enterprises.

Is directed at eliminating wage levelling,

once an honored objective, by rewarding the skilled and productive. Moreover, successful enterprises are to be allowed to keep more of their profits, creating pressures to eliminate redundant workers in order to distribute a larger share of profits among the remaining workers. The wage reform structure also threatens to disproportionately reward professionals to the detriment of the traditionally favored working class.

- * Wage reforms have gone slowly, largely because enterprises have not been profitable enough to implement them, but the Soviets still seem fully intent on substantially widening wage differentials.

Retail price reform - To reduce government subsidies and bring supply and demand more into line.

Threatens to cut the safety net that allows the poorest segment of the populace (theoretically) to have access to basic necessities--food, housing and health care.

- * These will be among the last reforms to be implemented because of the great controversy surrounding them and the uncertainties about how to compensate the losers.

Wholesale price reform - To allow more flexibility in the formation of prices in order to better reflect scarcities of inputs and customer preferences.

Allows the market more influence over Soviet economic activity, increasing the potential for its reputed evils--inflation unemployment, "unearned" profits, cyclical fluctuations.

- * Although this reform is just being formulated, it appears that it will entail price revisions and not a reform of the price mechanism itself; the Soviets are still too fearful of the consequences of letting go.

Looser controls over the private sector - To unleash private initiative by allowing the formation of cooperatives and individual labor activity.

Encourages the development of characteristics previously eschewed in the making of the Soviet Socialist man--self interest, competition, "money-grubbing." Also fuzzes somewhat the bedrock of socialism--state ownership of the means of production.

- * Although substantial controls over private activity have been lifted, private entrepreneurs must still contend with both public and official hostility. The leadership faces an uphill battle in breaking down this psychological barrier.

Democratization at the workplace - To allow the workers to elect their managers as well as workers councils that participate directly in production and labor decisions.

Violates the Lenin-ordained principle of one-man plant management and gives the workers a greater potential to challenge the role of the party in the economy.

- * Slow progress on democratization indicates that the Soviets have not reconciled themselves to this idea. Some elections have been disallowed and the workers reminded that the party must still play a central role. Such actions will lead to greater worker apathy.

Agricultural reforms - To give the farmer a personal interest in the land by allowing him to contract with the farm and pocket the profits.

Appears at variance with the basic reasons for collectivization--the submergence of the individual to the group and the liquidation of a the kulak "class."

- * Central controls are still maintained over farms and therefore over the private contracting process.